

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
MIKE AND NORMA HIRSCH,)
RALPH AND DOROTHY HIRSCH,)
AND IRVING AND PEGGY BERMAN)

Appearances:

For Appellants: Samuel W. Lebowitz and
Edgar Raymond Morris
Certified Public Accountants

For Respondent: Lawrence C. Counts
Associate Tax Counsel

O P I N I O N

These appeals are made pursuant to sections 18594 and 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests against proposed assessments of additional personal income tax and on a claim for refund of personal income tax in the following amounts for the years specified:

<u>Appellants</u>	<u>Years</u>	<u>Proposed Assessments</u>	<u>Refund Claim</u>
Mike and Norma Hirsch	1959	\$ 1,542.17	
Ralph and Dorothy Hirsch	1959	2,214. 23	\$ 332.47
Irving and Peggy Berman	1958	29.60	
	1959	5,069.97	
	1960	77.47	

The issues presented are (1) whether a corporation in which appellants 'held stock was "collapsible" so that ordinary income rather than capital gain was realized by

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appellants when the corporation distributed its property to them in liquidation; (2) whether the fair market value of the property received by appellants upon the liquidation was less than the value determined by respondent; (3) whether appellants reported an excessive amount as their share of rental income derived by the corporation; and (4) whether respondent properly disallowed the deduction of part of the amounts claimed by the Bermans as expenses necessary for the production of income. An additional issue, which led to the proposed assessment against the Bermans for the year 1958, has been conceded by respondent.

Appellants Mike Hirsch and Ralph Hirsch are partners in a real estate investment firm known as H & H Investment Co. The partnership, together with appellant Irving Berman and a person who is not a party to these appeals formerly owned unimproved land in Beverly Hills, California, as tenants in common.

In 1954 the Beverly-Olympic Corporation was formed and the land was conveyed to it. In return, H & H Investment Co. and Irving Berman each received 46.67 percent of the corporation's stock,

In June 1956 the corporation formed a partnership with persons who are not directly involved here, to construct an office building on the land. The corporation held a 75 percent interest in the partnership. Construction began in 1957 and was virtually completed in that year. The property produced gross rentals of \$208,035.61 and \$265,224.28 for the years 1958 and 1959, respectively,

In 1959 the Beverly-Olympic Corporation distributed its property to its stockholders in liquidation and dissolved.

I

COLLAPSIBLE CORPORATION ISSUE

The first issue is whether the Beverly-Olympic Corporation was "collapsible" so that ordinary income rather than capital gain was realized by appellants when the corporation distributed its property to them. Appellants contend that the corporation did not fall within the statutory definition of a "collapsible corporation" because appellants did not have, prior to completion of the office building, the requisite view toward liquidation.

Section 17411 of the Revenue and Taxation Code provides so far as material here, that gain from a distribution made by

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a collapsible corporation shall be considered as gain from the sale or exchange of property which is not a capital asset. Section 17412 provides in part that:

(a) ... the term "collapsible corporation" means a corporation formed or availed of principally for the manufacture, construction, or production of property ..., with a view to --

(1) The sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, before the realization by the corporation ... of a substantial part of the taxable income to be derived from such property; and

(2) The realization by such shareholders of gain attributable to such property.

* * *

The corporation is collapsible if the view toward the distribution described by section 17412 exists at any time during construction of the property and if the distribution is not attributable solely to circumstances arising after construction, (Cal. Admin. Code, tit. 18, reg. 17411-17414(b), subd. (1)(C).)

In the record before us, we find no support for appellants' contention that they did not have, prior to completion of construction, any view toward liquidation. They have not presented any oral or documentary evidence whatever concerning their view, and there is no indication that the distribution was motivated by circumstances which arose after construction was completed. We conclude, therefore, that the Beverly-Olympic Corporation was collapsible and that ordinary income rather than capital gain was realized by appellants when the corporation distributed its property to them.

II

FAIR MARKET VALUE ISSUE

The second issue is whether the fair market value of the property received by appellants upon the liquidation was less than the value determined by respondent. *The answer to this issue will determine the amount of the taxable income realized on the liquidation.

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Appellants contend that the value of the property at the time of the liquidation in 1959 was \$1,044,000. This amount represents the average of two appraisals which appellants obtained in 1963. One of the appraisals specifies a value of \$1,063,000 and the other specifies a value of \$1,025,000.

Respondent contends that the value of the property was \$1,200,000. Respondent points out that the higher of the two appraisals obtained by appellants fails to describe the factual basis for, or the method of, valuation, and that the other appraisal report contains internal errors. The internal errors found by *respondent consist of* an understatement of the square footage in the office building and a mathematical error. By correcting these errors, respondent arrived at a value of \$1,214,124, which it rounded off to \$1,200,000. Based upon income capitalization formulas obtained from local real estate brokers; respondent concluded that the value determined by it was not excessive.

In our opinion, the value arrived at by respondent was reasonable. Appellants have not satisfactorily explained the internal errors in the one detailed appraisal which they have presented. The result obtained by correcting those errors, considered together with the large rental income derived from the property, lends support to a value at **least** as high as that determined by respondent.

III

EXCESSIVE REPORTING ISSUE

The third issue is whether appellants reported an excessive amount as their share of rental income derived by the corporation,

Appellants originally stated in their appeals, without further elaboration, that an amount of \$64,080.11, representing their share of the rental income derived by the corporation in 1959, was not taxable to them. No specific reason was given for this conclusion. At the subsequent oral hearing, they argued that this amount represented the repayment of loans made by them to the corporation. No evidence was offered in support of the argument until after the hearing, when appellants submitted a copy of a balance sheet for the Beverly-Olympic Corporation, dated November 1, 1959. The balance **sheet** lists total liabilities and capital of \$276,257.45, including \$260,546.50 classified as loans payable to officers, \$1,000 as subscriptions to capital stock, and \$14,710.95 as earned surplus.

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The evidence thus submitted is untimely and unconvincing. The land contributed by appellants to the corporation had a very substantial value. Since the balance sheet does not otherwise refer to this contribution, it appears that it was classed on the balance sheet as "loans payable." Appellants' contribution of land was presumably reflected in the computation of their gain on the liquidation. There is no contention or evidence to the contrary.

On the record before us, we cannot find that appellants reported an excessive amount of income.

IV

EXPENSE DEDUCTION ISSUE

The final issue is whether respondent properly disallowed the deduction of part of the expenses claimed by Irving and Peggy Berman as expenses necessary for the production of income.

In their returns for 1959 and 1960, the Bermans claimed deductions for expenses allegedly incurred for travel, entertainment, and selling in connection with Mr. Berman's activities as an investor. These deductions were in the amounts of \$8,020.08 for 1959 and \$7,654.46 for 1960. Respondent disallowed \$4,042.11 of the deductions for 1959 and \$2,020 of the deductions for 1960 on the ground that these claimed expenses were not substantiated.

The Bermans have not offered to us any proof at all that they are entitled to the deductions claimed. We must, therefore, sustain respondent's action. (Cal. Admin. Code, tit. 18, § 5036.)

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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Ralph and Dorothy Hirsch, and Irving and Peggy Berman.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to sections 18595 and 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on protests against proposed assessments of additional personal income tax and on a claim for refund or" personal income tax in the following amounts for the years specified be and the same is hereby sustained:

<u>Appellants</u>	Years	<u>Proposed Assessments</u>	<u>Refund Claim</u>
Mike and Norma Hirsch	1959	\$ 1,542.17	
Ralph and Dorothy Hirsch	1959	2,214.23	\$ 332.47
Irving and Peggy Berman	1959 1960	5,069.97 77.47	

IT IS FURTHER ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Irving and Peggy Berman against a proposed assessment of additional personal income tax in the amount of \$29.60 for the year 1958 be reversed.

Done at Sacramento, California, this 24th day of
April 1967, by the State Board of Equalization.

Paul R. Leake, Chairman
John W. Lynch, Member
Robert H. Hill, Member
Richard Lee, Member
Kenber

ATTEST: Fuller, Secretary